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**FINANCIAL MANAGEMENT:
Report on Internal Control Over
Financial Reporting of the U.S. Customs Service
For Fiscal Year 2002**

OIG-03-033

December 16, 2002



Office of Inspector General



OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 16, 2002

MEMORANDUM FOR ROBERT C. BONNER, COMMISSIONER
UNITED STATES CUSTOMS SERVICE

FROM:

William H. Pugh *William H. Pugh*
Deputy Assistant Inspector General
For Financial Management and Information
Technology Audits

SUBJECT:

Report on Internal Control over Financial
Reporting of the U.S. Customs Service for Fiscal
Year 2002

I am pleased to transmit the attached report on Internal Control over Financial Reporting of the U.S. Customs Service (Customs) as of and for the Fiscal Year (FY) ended September 30, 2002. We contracted with KPMG LLP, an Independent Public Accountant (IPA), to examine Customs' internal control over financial reporting. The IPA performed the examination in accordance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements Number 10 and generally accepted government auditing standards. The attachment includes the following:

- Independent Accountants' Report on Internal Control over Financial Reporting;
- Exhibit I - Material Weaknesses;
- Exhibit II - Reportable Conditions; and
- Exhibit III - Status of FY 2000 Findings Presented in the Inspector General's Report.

The IPA issued a qualified opinion on the internal control over financial reporting of Customs as of and for the FY ended September 30, 2002. The IPA qualified its opinion due to the following limitation of scope and four material weaknesses:

Limitation of Scope

Security clearance procedures and other matters, related to the access and handling of sensitive information, delayed the start of the information technology evaluation. This delay prevented the IPA from completing its testwork on information technology general and application controls.

Material Weaknesses (See Exhibit I of the Attachment.)

The IPA identified the following four material weaknesses as part of its examination:

- Customs did not adequately monitor the effectiveness of its internal controls over the entry duties and taxes in 2002.
- Drawback controls need to be strengthened.
- Customs information technology system logical access and software maintenance security controls need improvement.
- Core financial systems need to be improved and integrated (repeat condition).

Except for the effects of the limitation of scope and material weaknesses noted above, the IPA concluded that Customs maintained, in all material respects, effective internal control over financial reporting as of and for the year ended September 30, 2002, based on the *Standards of Internal Control in the Federal Government*, issued by the United States General Accounting Office. In addition, the IPA noted the following items, included in Exhibit II, which though not material weaknesses, are considered reportable conditions:

- Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.
- Customs did not adequately monitor movement of in-bond merchandise and did not measure the extent of compliance with Customs policies in 2002 (repeat condition).

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- Internal control over the drawback process in New York/Newark was negatively affected by the events of September 11, 2001.
- Documentation of the entity-wide security program needs to be improved.
- There are internal control findings that affect Customs ability to comply with laws and regulations.

My staff's review of the IPA's working papers determined that the work was performed in accordance with generally accepted government auditing standards. Should you have any questions, please contact me at (202) 927-5430, or a member of your staff may contact Louis King, Director, Financial Audits at (202) 927-5774.

Attachment



2001 M Street, NW
Washington, DC 20036

Independent Accountants' Report on Internal Control over Financial Reporting

Office of the Inspector General
United States Department of Treasury

The Commissioner
United States Customs Service:

We have examined the effectiveness of the United States Customs Service (Customs) internal control over financial reporting as of and for the year ended September 30, 2002, based on the *Standards for Internal Control in the Federal Government* (Standards), issued by the United States General Accounting Office (GAO) in November 1999. Customs management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Except as described below, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing, and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Customs operates an automated information technology system to assess, collect and report duties and excise taxes on merchandise entering the United States from foreign countries and to refund duties when imported merchandise is shipped out of the United States. Security clearance procedures and other matters, related to access and handling of sensitive information, delayed the start of the information technology evaluation and prevented us from completing our testwork on information technology general and applications controls. Consequently, we were also unable to verify whether information technology system controls exist that may mitigate the weaknesses in the design and operating effectiveness of internal controls over entry duties and taxes assessed, and drawback claims of duties collected.

Because of inherent limitations in any internal control, misstatements due to errors or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We noted certain matters, described in Exhibits I and II, involving internal control over financial reporting and its operations that we consider to be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters



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coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Customs ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. We believe that the reportable conditions presented in Exhibit I are material weaknesses. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. A summary of the status of the Department of Treasury Office of Inspector General fiscal year 2000 reportable conditions is included as Exhibit III.

In our opinion, except for the effect of the material weakness described in Exhibit I on the achievement of the objectives of the control criteria defined in the Standards and the effect of matters we may have discovered had we been able to complete our testwork on information technology general and application controls, Customs maintained, in all material respects, effective internal control over financial reporting as of and for the year ended September 30, 2002, based on the Standards referred to above. We do not express an opinion or any other form of assurance on cost-benefit statements that may be contained in managements' response to our recommendations contained in Exhibits I and II.

This report is intended solely for the information and use of the Customs management, the Department of Treasury Office of Inspector General, Office of Management and Budget and U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 12, 2002

Material Weaknesses

1. Customs did not adequately monitor the effectiveness of its internal controls over the entry duties and taxes in 2002.

Customs has adopted a “risk management based” approach to design and implement internal controls over trade compliance. It is not practical or cost effective to examine every shipment and entry document for all merchandise entering the United States and the Customs Modernization Act of 1993 placed the burden of compliance with trade laws, including the proper calculation and remittance of duty, on the importer. To execute the risk management based approach, Customs uses a multi-disciplinary network of employees in numerous mission specific operations, stationed in ports of entry throughout the United States and at national offices in Washington DC. These personnel have access to sophisticated computer and statistical tools and techniques that can be used to “target” imports for review and examination. Target criteria are developed based on an assessment of the risk of non-compliance with trade laws, including revenue assessment, and other mission related objectives, e.g. antiterrorism, contraband-enforcement. The target criteria are continuously refreshed and updated from analysis of historical and new information. Imports that pass the target criteria as well as other in-depth pre-entry analyses and automated system edits are allowed to enter the United States without further review. These imports are also subject to post-entry analysis conducted by staff in several different Customs operations. Use of targeting criteria is intended to optimize use of limited resources – dedicating inspector and specialist reviews in areas of greatest perceived benefit and/or minimization of risk. Significant reliance on the operating effectiveness of IT applications and other coordinated controls is a necessary component of this approach.

By design, the risk management based approach to internal control over entry does not subject every import to the same set of controls. Since imports are subjected to different controls, depending on the assessment of risk, a measurement of the overall effectiveness of the system of controls must be performed to provide reasonable assurance that the targeting process is achieving the intended results. Measurement of results and projection to the total population is essential to a system that depends on a sample to be representative of the whole.

In previous years, Customs used Compliance Measurement (CM) for this purpose. The CM program uses a statistical sampling method to select (i) import shipments for physical examination of the cargo and (ii) entry documents submitted by importers and brokers for detailed review. CM was designed principally as a measurement of control effectiveness. The results of CM reviews were compiled and used to project the overall compliance with U.S trade laws, regulations and agreements, and estimate a revenue gap (over/under vs. actual collections of revenue). The revenue gap calculation enabled financial management to monitor the effect of discrepancies on the financial statements and ultimately determine if revenue collections reasonably approximated those actually due.

However, after the events of September 11, 2001, CM was intentionally not performed during the majority of 2002 and consequently Customs lacks a statistically valid measurement of the effectiveness of its system of internal controls over the entire entry process for 2002. Inspections of merchandise and review of importer and/or broker submitted entry documentation performed in 2002 were non-statistical and judgmental, and could not be used to measure the overall extent of trade compliance. The lack of statistical measurement hinders Customs ability to determine the extent of Customs compliance with laws and regulations, and whether the duty collected materially approximates the amount that should have been collected (the revenue gap).

In addition, the weakness in logical access and software maintenance controls, described in material weakness #3 below, reduced the reliability of Customs automated system edits – a critical element of the entry control infrastructure. We also noted deficiencies in control activities performed by various port personnel that indicate a weakness in manual controls performed over entry, such as lack of documented authorization and untimely resolution of system edit report data.

The Inspector General's fiscal year 2000 report described several weaknesses of the CM program for which we are unable to determine the status of corrective actions taken by Customs, if any (see Exhibit III).

Recommendations

The *Standards for Internal Control in the Federal Government* (Standards) issued by the General Accounting Office (GAO), state that "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations." The Information and Communications section of the Standards, states that information should be recorded and communicated to management and others within the entity who need it and in a form and timeframe that enables them to carry out their internal control and other responsibilities. It further states that for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events.

The Office of Management and Budget (OMB), Circular A-123, *Management Accountability and Control*, "management controls are the organization, policies, and procedures used by agencies to reasonably ensure that...reliable and timely information is obtained, maintained, reported and used for decision making." Furthermore, "Federal managers must take systematic and proactive measures to develop and implement appropriate, cost-effective management controls."

Also, OMB Circular A-123 requires agencies to establish and maintain a cost-effective system of internal controls to provide reasonable assurance that Government resources are protected against fraud, waste, mismanagement or misappropriation and that both existing and new program and administrative activities are effectively and efficiently managed to achieve the goals of the agency. All levels of management shall be involved in ensuring the adequacy of internal controls. Specifically, OMB A-123 states that financial managers must incorporate certain specific management control standards and

ensure that transactions are promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports.

These standards are even more important to a process that (1) depends on voluntary compliance of thousands of importers and (2) uses sampling techniques to determine the extent of internal control to apply to individual transactions.

We recommend that Customs management reinstate a CM program that yields statistically valid results to quantify a revenue gap analysis and provide trade compliance results. If properly designed, the CM should provide a system of measurement to determine the effectiveness of controls over the entry process. The design should subject the entire population of cargo and entry summary documentation to examination and samples would be taken based on statistical sampling methodologies. The CM should address and accomplish the objectives of control environment, risk assessment and monitoring.

We also recommend implementation of the recommendation in material weakness #3 to strengthen the reliability of the overall entry infrastructure.

Because the Customs CM program was suspended for the majority of 2002, we did not evaluate the program's design and therefore, cannot conclude that re-instatement of CM used in previous years will completely accomplish these objectives.

2. Drawback controls need to be strengthened.

The Automated Commercial System (ACS) does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries or export documentation upon which the drawback claim is based. The ACS rejects drawback claims for verification when the amount of the claim is greater than the amount collected. However, the drawback module cannot electronically compare and determine whether duplicate drawbacks were claimed for merchandise at the invoice line-item level for previously claimed drawbacks. In addition, export information, a critical component of the drawback claim, is not currently available to be linked to the drawback module; and it prevents the electronic comparisons of export data within ACS.

Because comparisons of entry and export information cannot be performed electronically, Customs relies on a risk management based approach for controls over reviewing drawback claims. Since it is a risk management based approach, every drawback claim is not subject to the same level of review or internal controls.

Customs drawback risk management based selectivity process identifies drawback claims for review based upon first claim filings, random statistical hits, and a number of different criteria. Since drawback claims are subjected to different levels of review, depending on the assessment of risk, a measurement of the overall effectiveness of the system of controls must be performed to provide a reasonable assurance that the risk

management based approach is achieving the intended results. Measurement and projection of the results to the entire population of drawback claims and the financial statements is essential to a system that depends on a risk management based methodology to controls.

Customs selective drawback processing methodology is designed to allow for the measurement and statistical projection of the results. However, Customs drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of system-selected consumption entries randomly selected for review, if they exceed thirty to a baseline of thirty items. This judgmental reduction in sample items tested impedes Customs ability to statistically measure and project the results of their drawback program.

Currently, criteria based selections, first claims and a five percent random selection of drawback claims are reviewed under the selectivity system. These items receive a full desk examination. Only those valued over \$50,000 are reconciled, a process requiring the examination of all related drawback claims. Furthermore, only the largest valued related import entry is required to be verified to all related drawback claims. Since only the largest valued related import entry against a selected drawback claim is verified, Customs is unable to determine whether, in the aggregate, an excessive amount was claimed. Since all of the related import entries are not reviewed and analyzed, errors and omissions could exist that would not be detected. Therefore, overall measurement and statistical projection of the results cannot be determined.

Recommendations

The Standards require that information be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities. The Standards also require that internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

In addition, OMB Circular A-123 management and accountability control requirements cited in material weakness #1 above apply equally to this drawback condition.

We recommend that Customs:

- Implement effective internal controls over drawback claims as part of any new systems initiatives;
- Revise current policies and procedures to provide a better statistical methodology to select items to review and reconcile all prior related import entries selected for review; and
- Ensure that the results of the drawback selectivity testing are monitored by measurement and statistically projected to determine the reasonableness of financial statement balances.

3. Customs IT system logical access and software maintenance security controls need improvement.

As mentioned in our Independent Accountants' Report, we were unable to complete our testwork on Customs information technology system general and applications controls due to delays caused by Customs security clearance procedures and other matters related to access and handling of sensitive information. Had we been able to complete our testwork, other matters may have been discovered that would have been reported to you.

Based on the procedures we were able to complete, we noted the following:

Network and host-based system configuration vulnerabilities exist that can potentially be used to compromise Customs system security. Also, Customs has not taken all necessary measures to ensure that required password policies, and procedures are implemented correctly. System vulnerabilities and ineffective password management practices can expose sensitive Customs resources to unauthorized use, loss, or modification. Without effective controls to ensure that access to systems is appropriately restricted to authorized employees, Customs is at risk that unauthorized persons could access sensitive applications and data.

We identified several other deficiencies in Customs logical access controls over its data files, application programs, and computer-related facilities and equipment. Such controls protect against unauthorized modification, disclosure, loss, or impairment.

We also noted that several vendor supplied software patches have not been installed. Some of the patches affect the system controls related to denial of service, privilege escalation, circumvention of access controls, and information disclosure.

Due to the sensitive nature of these matters, we have provided further details in a separate report with limited distribution.

Recommendations

The ISSB System Security Handbook states that individuals with access to Customs Systems must "choose hard to guess but easy to remember passwords." The NDC Z/OS Mainframe Infrastructure Security Design V1.1 documents states; "Users who access the mainframe via their LAN terminals must first logon to the Customs LAN using a different User ID and password.

The Information Systems Security Policy and Procedures Handbook, states that assurance should be provided that, (1) user IDs and passwords conform to the standard and (2) systems parameters are set in such a manner that passwords are prohibited from reuse for at least six generations, which means that a user cannot use the same password for at least six generations of password change. Users should be reminded of Customs password policy.

NIST Special Publication 800-14, Generally Accepted Principles and Practices for Securing Information Technology Systems, section 3.5.2 User Administration states that “Organizations should ensure effective administration of users’ computer access to maintain system security, including implementation and enforcement of effective user account password management practices.”

In addition, OMB Circular A-130, Appendix III – Security of Federal Automated Information Resources, states that agencies shall provide adequate security for all information processed, transmitted, or stored in Federal automated information systems. Of particular importance are technical and operational controls as part of management controls to prevent and detect inappropriate or unauthorized activities.

We recommend that Customs consider as part of Customs IT capital planning initiatives, improvement/migration IT strategies for current network and host-based system configurations to reduce likelihood that sensitive and critical Customs systems can be compromised.

We also recommend that Customs enforce stated password management policy and consider implementing the industry “best practice” recommendations on all Windows NT hosts to enhance security of the Customs IT infrastructure.

Customs should also enforce stated password management policy and consider implementing industry “best practice” recommendations on all Windows NT hosts to enhance security of Customs IT infrastructure. We recommend that Customs ensure that steps are taken to ensure that passwords are unique for each system.

We recommend that Customs restrict access to sensitive-related functions based on the least privilege concept to the minimum number of personnel with a defined and documented need. This would include a full review to determine the appropriate number of users that should have system security administrator access with centralized privileges, removal of duplicate and inactive accounts and others with multiple privileges.

We also recommend that the most current operating system patches be installed on all systems. In the event that operational issues in application systems preclude installation of such patches, Customs should consider development of a migration strategy to replace applications for greater security of the operational environment. Patches are issued to address critical problems in the Network Operating System as well as addressing high-risk security vulnerabilities discovered in operating systems. Without these patches, an attacker could use known vulnerabilities to gain unauthorized access to the affected systems.

4. Core Financial Systems Need To Be Improved and Integrated (repeat condition).

Customs core financial systems did not provide certain financial information necessary for managing operations. Also, the financial systems did not capture all transactions as they occurred during the year, did not record all transactions properly, and were not fully integrated. Additionally, the systems did not always provide for essential controls with respect to override capabilities. As a result, extensive manual procedures and analyses were required to process certain routine transactions and prepare year-end financial statements.

Weaknesses in the core financial systems, some of which are repeat findings, and specific recommendations are discussed below:

- ***Automated Commercial System (ACS) Accounts Receivable Subsidiary Ledger –***
We noted that the ACS system cannot provide summary information on the total unpaid assessments for duties, taxes, and fees by an individual importer. Also, ACS does not generate periodic management information on outstanding receivables, the age of receivables or other data necessary for managers to effectively monitor collection actions. Customs also must utilize ad hoc reports and manual procedures to ascertain and adjust certain year-end accounts receivable balances. Collectively, these conditions increase the likelihood that an error would occur and not be detected.

Recommendation

The Joint Financial Management Improvement Program's (JFMIP) *Core Financial System Requirements*, states that the core financial system must maintain detailed information by account sufficient to provide audit trails and to support billing and research activities. Together with the design of Customs new accounting system or as Customs makes normal enhancements to the current IT systems and processes and once management has considered the cost/benefit trade-off of system enhancements, we recommend that Customs consider adopting a "customer-based" accounts receivable subsidiary ledger that is capable of aging the accounts and that interfaces with the general ledger system.

- ***Cost Accounting –*** The Cost Management Program, Customs primary control used to implement, maintain and manage improvements to the Cost Management Information System (CMIS), did not report cost information on a regular basis throughout fiscal year 2002. This is because core financial systems were not integrated to enable financial personnel to capture and analyze cost information for fiscal year 2002 at their lowest levels without the use of the annual survey process, which Customs has relied upon in previous years. Additionally, Customs currently produces cost management information only at year-end. Cost management information should be produced on a regular basis throughout the fiscal year to provide management with relevant and timely information upon which to base operational decisions.

Recommendation

The JFMIP's *Core Financial System Requirements*, states that the core financial system must support managerial cost accounting by providing (i) the capability to measure and report the costs of each segment's outputs and (ii) complete, reliable, consistent, timely and useful financial management information on operations to enable central management agencies, individual operating agencies, divisions, bureaus, and other sub-units to carry out their fiduciary responsibilities. It further states that the core financial system must support the ability to capture fees and other charges imposed by the agency for services and things of value it provides. These costs should be captured at the lowest level to reflect actual costs incurred by the agency in providing goods and services.

We recommend that Customs management integrate financial systems to enable them to eliminate the survey process and report cost information on a periodic basis throughout the year. Management has reported that the interface from source legacy systems, including COSS was integrated in the SAP database in October 2002 that will enable CMS to eliminate the survey process and report cost information on a monthly basis in 2003.

- ***Recording Certain Transactions In The General Ledger System*** – Certain transactions are not properly recorded in the general ledger system as they occur. Customs did not program its general ledger system, specifically the Asset Information Management System (AIMS) to properly record transactions for financial reporting purposes. For example, the AIMS is programmed to record all transactions as an appropriated transaction, including those that should be recorded as a non-appropriated transaction. Reimbursable transactions may be recorded as though they were an appropriated transaction when in fact they were reimbursable transactions. In addition, Customs is unable to record a liability in the general ledger upon receipt of goods or services. Because the system was not programmed for financial reporting purposes certain transactions are not recorded in a timely manner, e.g. accounts payable were not established and related obligations were not liquidated in the system in a timely manner. Additionally, Customs is required to create numerous adjusting journal entries, monthly, quarterly, and annually and manual reversing entries to compensate for the limitations in AIMS.

Recommendation

Section 7 of OMB Circular A-127, *Financial Management Systems* requires that financial events be recorded by agencies throughout the financial management system applying the requirements of the U.S. Government Standard General Ledger (SGL) at the transaction level. It further states that the criteria (e.g., timing, processing rules/conditions) for recording financial events in all financial management systems shall be consistent with accounting transaction definitions and processing rules defined in the SGL. In addition, the JFMIP's *Framework for Federal Financial Management Systems*, Chapter 3, states that financial event processing covers those mechanisms necessary to properly process and track data on financial events. It

further states that the system shall support activities associated with establishing payables and disbursing funds.

We recommend that Customs comply with applicable sections of OMB Circular A-127 and JFMIP, by properly recording all transactions in the general ledger as they occur.

- ***Systems Integration*** – We noted that the CARMAC (aircraft parts) and CAMITS (marine parts) are both contractor owned systems that are not fully interfaced with the AIMS (Customs general ledger system), which cause timing differences in reporting information during the year. Because the systems are not interfaced, inventory purchases and payments are not accurately applied during the year. Purchases of aircraft and marine parts are reconciled to AIMS on a quarterly basis; however the payments are recorded in AIMS on a bi-weekly basis. Except for the quarterly adjustments AIMS does not accurately reflect inventory balances and activity at any time throughout the year.

We also noted that the Property Information Management System (PIMS) utilized to account for and track personal property, was not fully integrated with the Asset Management Information System (AIMS).

Recommendation

With the implementation of SAP Release 2 on October 1, 2003, replacing PIMS with the Asset Accounting (AA) module of SAP R/3, some of these matters are expected by management to be addressed and corrected. We recommend that Customs consider interfacing CARMAC and CAMITS with AIMS/SAP when implemented. We recommend Customs ensure that PIMS and AIMS/SAP when implemented are fully integrated.

Reportable conditions

5. Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.

Customs has a nationally mandated policy that requires periodic operator compliance reviews of operators of bonded warehouses and foreign trade zones (FTZ). The ability of Customs to monitor the quantity and type of goods moving in and out of bonded warehouses and FTZ's, and eventually collecting proper duties, is reliant on the performance of the operators in maintaining compliance with Customs policies and procedures.

In several port locations, reviews of bonded warehouse and FTZ operators were not performed and in other locations these reviews were substantially curtailed. When reviews were conducted, the extent of review was often locally determined and dependent on available resources, which varied by port. We also noted inconsistent documentation and follow-up on bonded warehouse and FTZ operator reviews that were conducted during 2002 and in previous years. Findings were reported to the operators without a clear schedule of expected corrective actions, timing and expected post-review procedures.

Recommendations

The Standards state that:

- "Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved;"
- "Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved," and
- "Program managers need both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources."

We recommend that Customs management perform periodic spot-check inspections of bonded warehouses and foreign trade zone operators. A standard national checklist should be used while conducting the reviews to ensure that reviews are performed consistently throughout the United States and findings and recommendations can be used to refresh the reviews. Specific corrective action plans or advisory reports should be provided to the operator, together with an expected timetable for correction of findings. Finally, Customs should make periodic follow-up reviews to assess the progress made on corrective action plans until the findings have been adequately addressed.

6. Customs did not adequately monitor movement of in-bond merchandise and did not measure the extent of compliance with Customs policies in 2002 (repeat condition).

In the ports subject to examination, we noted that the Inspectors do not always verify the quantity and type of cargo prior to the in-bond movement. In some situations the reports of movements did not match the arrived-at-destination reports. System and procedural limitations can complicate or even prevent adequate reconciliation and matching of movements. For example, Customs policy does not require carriers to submit exportation documentation; rather, they are required to notify Customs of exportation. This creates an opportunity for cargo designated as exportation to be entered as a portion of an entry made for a separate shipment. In some locations we visited, we noted conflicting information regarding the description of the unit of measure from the originating and destination ports, which generated unmatched quantities in ACS. Reports of overdue in-bond shipments showed that a number of in-bond movements were overdue or undelivered and the overdue in-bond movements were not always resolved in a timely manner, including those coded for exportation.

We also noted that Customs uses a compliance measurement program within the “Tinman” In-bond Module, which is similar to the CM program used in the entry process, to select, review and determine overall compliance of in-bond movements. However, this portion of Tinman was suspended during fiscal year 2002 to allocate resources to other mission related objectives. Customs performed some in-bond testing at the end of fiscal year 2002, however the tests were inconclusive. Thus Customs was unable to reliably measure over-all compliance with its in-bond policies.

Recommendations

The Standards state that:

- “Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved,”
- “Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved,” and
- “Program managers need both operational and financial data to determine whether they are meeting their agencies’ strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources.”

Because Customs assesses the appropriate duty calculation after in-bond movements occur and merchandise reaches its final destination, it is important that these movements be closely monitored. We recommend that Customs management improve the control environment by:

- Developing and implementing policies and procedures regarding tracking and closing of in-bond movements, and
- Reinstating compliance measurement audits over the in-bond movement process.

7. Internal Control over the drawback process in New York/Newark was negatively affected by the events of September 11, 2001.

On September 11, 2001 the Customs New York City drawback office was completely destroyed along with all hard copy documentation related to the drawback process. Customs revised drawback-processing procedures for the drawback office that superseded the traditional full-desk review and selective drawback processing procedures that are currently in effect nationally. The selectivity based full-desk review performed prior to September 11, 2001 included review and analysis of original hard copy supporting documentation. The supporting documentation reviewed included proof of export and related consumption entry information. The documentation required for a full-desk review performed subsequent to September 11, 2001 is limited to ACS system information that is not supported by original hard copy documentation. The following findings are noted as they relate to the new procedures established in the New York/Newark drawback office based on the events of September 11, 2001.

- Customs did not implement procedures with respect to liquidating drawback claims of \$250,000 or more. Approximately 30 Drawback claims are currently in suspense and another 117 drawback claims greater than \$250,000 are in the ACS system and will be available for liquidation. Until liquidation procedures are implemented those claims available for liquidation will remain open. It should be noted that not all of these drawback claims in suspense are available for liquidation.
- The self-inspection program was suspended for fiscal year 2002. Customs could not effectively complete this program due to the total loss of documentation required for the review. This self-inspection program was used as an internal control over liquidated drawbacks claims to mitigate the risk that a drawback initially reviewed under the selectivity process was improperly performed.
- Customs does not verify all drawback claims selected for review amounts less than \$250,000 to original consumption entries filed in New York prior to September 11, 2001. The New York/Newark office will only reconstruct paper documentation for claims selected for review that are found discrepant in a desk review. Non-discrepant claims are not verified to the paper documentation as they would be in other drawback offices. These drawback claims are subject to the random drawback selectivity process, however since the documentation was completely destroyed Customs is unable to complete required the drawback selectivity testing over these items.

Recommendations

The Standards require that internal control activities be performed to help to ensure that management's directives are carried out. Internal control should also provide for an assessment of the risks that the agency faces from both external and internal sources. The Standards also require that management identify risks and perform appropriate risk assessments. All significant interactions between the Customs and the drawback claimants as well as internal factors at both the entity wide and activity level should be

considered. This includes Customs determination of the assessment of risk over each claimant for the possibility of the submission of excessive drawback claims.

We recommend Customs:

- Implement the procedures to liquidate drawback claims of \$250,000 or more; and
- Implement a self-inspection program in New York/Newark.
- Examine alternative approaches to strengthen controls over subsequent drawback claims where documentation is no longer available.

8. Documentation of The Entity-Wide Security Program Needs To Be Improved.

As mentioned in our Independent Accountants' Report, we were unable to complete our testwork on Customs information technology system general and applications controls due to delays caused by Customs security clearance procedures and other matters related to access and handling of sensitive information. Had we been able to complete our testwork, other matters may have been discovered that would have been reported to you.

Supporting documentation in the NDC Mainframe Systems Accreditation Package contained inaccuracies and incomplete/unclear process descriptions. We noted the following:

- Deficiencies with the NDC Z/OS Mainframe Infrastructure Security Test Plan and Infrastructure Security Requirements;
- Inaccuracies in the NDC Z/OS Mainframe Infrastructure Security Features User Guide; and
- Incomplete process descriptions and documentation in the NDC Z/OS Mainframe Infrastructure Trusted Facility Manual

With inaccurate and unclear/incomplete process definitions in certification and accreditation documents, there is an increased likelihood for those processes to be either omitted or not implemented as intended in referenced and subordinate documentation.

Recommendation

NIST FIPS Pub 102, Guideline for Computer Security Certification and Accreditation, states that "Security certification is a technical evaluation for the purpose of accreditation, and uses security requirements as the criteria for that evaluation; security accreditation is management's approval for operation, and is based on that technical evaluation and other management considerations." "Security requirements are expressed in increasing detail as one progresses from high-level general descriptions of the system through lower levels of detailed specification. Evaluation for security certifications focuses on the determination of compliance with security requirements".

We recommend that the deficiencies and inaccuracies be identified and corrected. Certification and accreditation documentation package for the mainframe infrastructure should be reviewed for inaccuracies and incomplete process definitions, and corrected. Process documentation should be clear, complete and current in all NDC Z/OS manuals.

9. Internal Control Findings that Affect Customs Ability to Comply with Laws and Regulations.

The following represent our findings on the internal controls over processes that affect compliance with laws and regulations.

- **Cost Management (repeat condition)** – Customs has not corrected a finding identified in the fiscal year 2000 OIG report related to reporting on user fees and all fees it imposes for services and things of value in accordance with the CFO Act. and 19 U.S.C. § 58c.(f)(4). These reporting requirements are on a biennial basis, with fiscal year 2002 being the next opportunity to report. In a follow-up memo dated March 15, 2002, OIG determined that Customs remained in a noncompliance situation and is now also in noncompliance with 31 U.S.C. § 902(a)(8).

A review of COBRA and user fees and related costs for fiscal year 2000 was completed in 2001. Overall recommendations indicated that legislation would be required to amend the fees to better match actual costs. In February 2002, the User Fee Working Group recommended that legislation be introduced to revise user fees to reflect actual costs related to providing the services, however, specific fee recommendations were not made for the each activity. Customs user and COBRA fees do not appropriately match related costs.

Recommendation

Regulation 19 U.S.C. § 58c.(f)(4) states; “At the close of fiscal year 1988 and each even-numbered fiscal year occurring thereafter, the Secretary of the Treasury shall submit a report to the Committee on Ways and Means of the House of Representatives and Committee on Finance of the Senate regarding the fees imposed under...58c.(a)...(other than the excess fees determined by the Secretary under paragraph (5)) should be adjusted in order that the balance of the Customs User Fee Account approximates a zero balance.”

We recommend that Customs management (1) issue the report to Congress regarding COBRA fees for fiscal year 2002 and (2) review user fees for fiscal year 2002 and make recommendations regarding the fees versus related costs. Based on discussions with the Cost Management group management, the review of user fees for fiscal year 2002 will be finalized in fiscal year 2003. The Cost Management group management also noted that a draft of the report required pursuant to 19 U.S.C. 58c(f)(4) for fiscal year 2002 has been drafted and is in its initial review stages. We recommend that the Customs consult with the General Counsel’s office for specific compliance instructions wherever the law is subject to varied interpretation.

- **Individual Transaction Plan** – We noted that several contracts over \$100,000 did not contain an Individual Transaction Plan (ITP), as required by the Department of Treasury Acquisition Regulations (DTAR). Based on discussions with Custom

Exhibit II, continued

management it appears that the Customs Procurement Services misinterpreted the FAR and did not believe an ITP was required for personal services contracts over \$100,000. Accordingly, Customs is not in compliance with the Department of Treasury Acquisition Regulations FAR, Part 7.

Recommendation

According to the FAR, Part 7, “a written plan is required for each commercial source acquisition exceeding the simplified acquisition threshold (inclusive of all options and term extensions).” The simplified acquisition threshold is \$100,000. Plans are to be retained in the contract file, and updated for significant changes. We recommend Customs prepare an ITP for all contracts over \$100,000.

U.S. Customs Service
Status of Fiscal Year 2000 Findings Presented in the Inspector General's Report
September 30, 2002

FY 2000 Report Reference	FY 2000 Condition	Status
<i>Material Weaknesses:</i>		
1.	<i>Core Financial Systems Need to be Improved and Integrated</i>	Repeated Comment See Material Weakness #4
2.	<i>Effort to Ensure the Timely Restoration of Mission-Critical Systems Need to be Accelerated</i>	Unable to verify status due to limitation in the scope of our work.
<i>Reportable Conditions:</i>		
3.	<i>Drawback Controls Need to be Strengthened</i>	See Material Weakness #2
4.	<i>Compliance Measurement Programs Need to be Comprehensively Implemented to Identify the Revenue Gap and Assess Trade Law Compliance</i>	Partially Repeated Comment See Material Weakness #1 and Reportable Condition # 5 Partially unable to verify status due to limitation in the scope of our work.
5	<i>Controls over In-bond Shipments Need to be Strengthened</i>	Repeated Comment See Reportable Condition # 6
6.	<i>Entity-Wide Security Program Planning and Management Needs to be Improved</i>	Unable to verify status due to limitation in the scope of our work. See related Reportable Condition #8
7.	<i>Physical and Logical Access Controls Need to be Improved</i>	Unable to verify status due to limitation in the scope of our work. See related Material Weakness #3
8.	<i>Software Development and Change Controls need to be Fully Implemented for Legacy Applications and/or Systems</i>	Unable to verify status due to limitation in the scope of our work.

For a complete description of reportable conditions, including material weaknesses, noted in fiscal year 2000, see the U.S. Department of Treasury Office of Inspector General's report entitled; *FINANCIAL MANAGEMENT: Audit of the United States Customs Service's Fiscal Years 2000 and 1999 Financial Statements* (Report No. OIG-01-045, dated February 23, 2001).